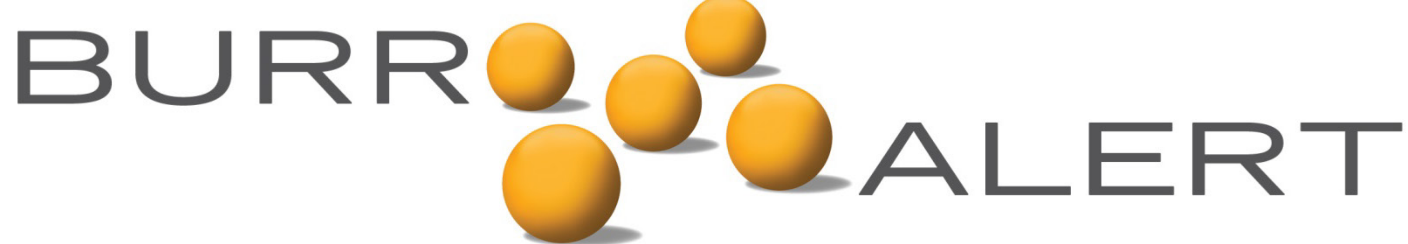

Supreme Court Denies Certiorari to Hear Bank of America's Challenge to Eleventh Circuit's Rule Regarding Lien Stripping in Chapter 7 Bankruptcy Cases

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The United States Supreme Court recently denied certiorari to an Eleventh Circuit appeal which would have addressed the issue of whether section 506(d) of the Bankruptcy Code permits a chapter 7 debt to "strip off"[1] a wholly unsecured junior lien in *Bank of America, N.A. v. Sinkfield*.[2] As a result, wholly unsecured junior creditors will continue to suffer the harsh consequence of having its junior lien completely "stripped off" in Eleventh Circuit bankruptcy cases, despite other Circuits around the country holding to the contrary.

The facts of *Sinkfield* are similar to other lien "strip off" cases that have been flooding Bankruptcy Courts in the Eleventh Circuit for the last few years.[3] In this case, the debtor owned real property that was subject to two mortgage liens.[4] At the time of the debtor's voluntary chapter 7 bankruptcy petition, the amount outstanding on the debtor's first-priority mortgage exceeded the fair market of the real property.[5] Relying on *In re McNeal*,[6] the debtor sought a court ruling holding that the mortgage lien asserted by Bank of America, who held the second-priority mortgage on the debtor's real property, could be avoided because the value of the real property did not extend to Bank of America's wholly unsecured junior lien.[7]

To put the Eleventh Circuit's reasoning in *McNeal* in perspective, we must first examine the Supreme Court's holding in *Dewsnup v. Timm*.[8] In *Dewsnup*, the Supreme Court concluded that a chapter 7 debtor could not "strip down" a partially secured lien under section 506(d) to the current value of the collateral.[9] The *Dewsnup* Court sought out to determine the meaning of the words "allowed secured claim" under section 506(d) of the Bankruptcy Code, and the Supreme Court came up with a two-step

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[1] "In bankruptcy terms, a 'strip down' of an undersecured lien reduces the lien to the value of the collateral to which it attaches and a 'strip off' removes a wholly unsecured lien in its entirety." *In re McNeal*, 477 Fed. App'x 562, 563 n.1 (11th Cir. 2012) (unpublished per curiam decision).

[2] No. 13-700, 2014 WL 1271326 (U.S. Mar. 31, 2014).

[3] *See* Joint Motion and Memorandum of Law for Summary Affirmance Subject to Appellate Review at *5, *Bank of America, N.A. v. Sinkfield*, 1:13-cv-01541-TCB (N.D. Ga. May 8, 2013) ("Between the time *McNeal* was decided and March 31[, 2013], 545 motions presenting this issue in the chapter 7 context were filed in the Northern District of Georgia alone.").

[4] *Id.* at *2.

[5] *Id.*

[6] 477 Fed. App'x at 564.

[7] Joint Motion and Memorandum of Law for Summary Affirmance Subject to Appellate Review at *2.

[8] 502 U.S. 410 (1992).

[9] *Id.* at 417.

test to determine whether a creditor has an "allowed secured claim" that is not subject to avoidance.[10] First, the Supreme Court examined whether the creditor's claim was "allowed" pursuant to section 502 of the Bankruptcy Code.[11] Second, the Supreme Court determined whether the creditor's claim was "secured by a lien with recourse to the underlying collateral."[12] Therefore, the *Dewsnup* Court was not concerned with whether the junior creditor's lien was wholly unsecured, but rather with the issue of whether the junior creditor's lien was based upon a properly-perfected security instrument. Because the junior creditor's claim in *Dewsnup* was secured by a lien and was fully allowed pursuant to section 502 of the Bankruptcy Code, the Supreme Court held that section 506(d) did not allow the debtor to "strip down" the junior creditor's lien.[13]

Notwithstanding the Supreme Court's prior holding in *Dewsnup*, the Eleventh Circuit in *McNeal* held that a chapter 7 debtor may avoid, or "strip off," a wholly unsecured mortgage lien on real property.[14] The Eleventh Circuit reasoned that the Supreme Court's holding in *Dewsnup* was not binding authority on the issue before the court because the debtor in *McNeal* sought a complete "strip off" of the lien, not just a partial "strip down."[15] After making its distinction between a "strip off" and a "strip down" of a lien, the *McNeal* court turned to the Eleventh Circuit's decision in *Folendore v. U.S. Small Business Administration*,[16] which was a bankruptcy case also involving wholly unsecured junior liens.[17] In *Folendore*, the Eleventh Circuit held that a debtor was allowed to avoid a "wholly unsecured" junior lien when a senior lien on the same property exceeded the value of the collateral.[18] Thus, the *McNeal* court concluded that because *Dewsnup's* facts were limited to a partially unsecured claim, *Dewsnup* did not abrogate *Folendore*, and consequently *Folendore* remained the controlling precedent within the Eleventh Circuit for wholly unsecured junior liens.[19]

Seeing it as pointless to try to overcome the Bankruptcy and District Courts in the Eleventh Circuit's strict adherence to the holdings in *McNeal* and *Folendore*, Bank of America entered into stipulated orders with the debtor stripping them of their lien at all three court levels so that it could appeal the issue to the United States Supreme Court or, in the alternative, have the Eleventh Circuit reconsider the issue *en banc*.[20]

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[10] *Id.* at 415.

[11] *Id.*; 11 U.S.C. § 502(a) ("A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.").

[12] *Id.*

[13] *Id.* at 417.

[14] *McNeal*, 477 Fed. App'x at 564.

[15] *Id.* at 564.

[16] 862 F.2d 1537 (11th Cir. 1989).

[17] *McNeal*, 477 Fed. App'x at 564.

[18] *Folendore*, 862 F.2d at 1538–39.

[19] *McNeal*, 477 Fed. App'x at 564.

[20] *See* Stipulated Order Resolving Contested Matter Subject to Right to Appellate Review at *2–*3, *Sinkfield v. Bank of America, N.A.*, No. 12-81094-JRS (Bankr. N.D. Ga. May 7, 2013); Joint Motion and Memorandum of Law for Summary Affirmance Subject to Appellate Review at *5, *Bank of America, N.A. v. Sinkfield*, 1:13-cv-01541-TCB (N.D. Ga. May 8, 2013); Order Granting Joint Motion for Summary Affirmance or, in the Alternative, to Expedite the Appeal at *1, *Bank of America, N.A. v. Sinkfield*, No. 13-12141-EE (11th Cir. July 30, 2013).

In Bank of America's Petition for a Writ of Certiorari, the bank presented three reasons for why the Supreme Court should hear the issue.[21] First, Bank of America asserted that the Eleventh Circuit's reasoning in *McNeal* and *Folendore* cannot be reconciled with the Supreme Court's holding in *Dewsnup*.[22] Second, Bank of America pointed out that all other courts of appeals to consider this issue, namely the Fourth, Sixth, and Seventh Circuits, have concluded that the Supreme Court's interpretation of section 506(d) in *Dewsnup* prevents a chapter 7 debtor from "stripping off" a wholly unsecured junior lien securing a valid mortgage loan.[23] Finally, Bank of America argued that this case presented an issue "of central importance to the administration of chapter 7 cases and to the treatment of home mortgages in particular," which the bank contended was an especially important issue following the crash of the housing market.[24] These arguments were insufficient to persuade the United States Supreme Court and Eleventh Circuit, however, as the United States Supreme Court denied certiorari and the Eleventh Circuit denied *en banc* consideration.[25]

Consequently, the Eleventh Circuit's reasoning in *McNeal* will continue as precedent in bankruptcy cases involving wholly unsecured junior creditors' liens, while other Circuits around the United States continue following the Supreme Court's holding in *Dewsnup* and not allow for wholly unsecured junior liens to be "stripped off." Until the United States Supreme Court addresses this circuit split, or the Eleventh Circuit reconsiders its holding in *McNeal*, creditors in the Eleventh Circuit should be prepared to have their wholly unsecured junior liens "stripped off" in chapter 7 bankruptcies.

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No representation is made that the quality of legal services to be performed is greater than the quality of legal services performed by other lawyers.

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[21] Petition for a Writ of Certiorari for Bank of America, N.A., *Bank of America, N.A. v. Sinkfield*, No. 13-700, 2014 WL 1271326 (U.S. Mar. 31, 2014), 2013 WL 6513773 at *11–*21.

[22] *Id.* at *12–*13.

[23] *Id.* at *14–*18 (citing *Ryan v. Homecomings Financial Network*, 253 F.3d 778, 782–83 (4th Cir. 2001); *In re Talbert*, 344 F.3d 555, 556 (6th Cir. 2003); *Palomar v. First American Bank*, 722 F.3d 992, 994 (7th Cir. 2013)).

[24] *Id.* at *18–*21.

[25] *Bank of America, N.A. v. Sinkfield*, No. 13-700, 2014 WL 1271326 (U.S. Mar. 31, 2014); Order Denying Appellant's Petition for Rehearing En Banc or, in the Alternative, Motion for Reconsideration En Banc, No. 13-12141-EE (11th Cir. Sept. 9, 2013).